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Date: OCTOBER 26, 2006

Legend

Decedent =

Wife =

Son =

Individual 1 =

Individual 2 =

Trust 1 =

Trust 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

a =

Dear :

This is in response to your February 22, 2006 letter in which you requested rulings concerning the estate and generation-skipping transfer (GST) tax consequences of the proposed exercise of a power of appointment.

The facts and representations submitted are summarized as follows:

Decedent died on Date 4. Prior to his death, Decedent created Trust 1 on Date 1 (prior to September 25, 1985). Son was living at the time Trust 1 was executed. Wife

was designated as the initial Trustee. Article Thirteenth provided that the trust is irrevocable except for certain powers retained by the Decedent, discussed below, to change the trustee.

Part I, Article First of Trust 1 provides that the trustee is to hold any property which is transferred to her by Decedent and/or the personal representatives of the Decedent during his lifetime in the "Lifetime Fund."

Part I, Article First (a) provides that until the death of Decedent, if there is a trustee serving other than, or in addition to Wife, then such other trustee may pay or apply to or for the benefit of Wife and/or Decedent's issue, so much, all or none of the net income and/or such sum or sums out of the principal of the Lifetime Fund, as the other trustee, in such other trustee's sole and nonreviewable discretion, deems advisable to provide for the care, maintenance, support, and education of Wife and/or Decedent's issue, as well as for any expenses incurred by or for her or them, or any of them, because of any illness, operation, infirmity, emergency, or for such other purposes, irrespective of cause or need, as such other trustee, in such trustee's sole and nonreviewable discretion, deems to be in the best interests of Wife and/or Decedent's issue.

Part I, Article Second provides that upon the death of Decedent, the trust corpus, including any assets received by the trustee by reason of Decedent's death (including life insurance proceeds) is to be held in the "Family Fund."

Part I, Article Second(a) provides that if Wife survives Decedent, then until the death of Wife, the trustee is to pay to Wife one-half of the net income of the Family Fund at convenient intervals, but not less often than quarter-annually.

Part I, Article Second(b) provides that in addition, the trustee, at any time or times that the trustee deems advisable, until the death of Wife, may pay or apply to or for the benefit of Wife and/or Decedent's issue so much, all or none of the net income remaining after the payments pursuant to Article Second(a), and such sum or sums out of the principal of the Family Fund, as the trustee, in trustee's sole and nonreviewable discretion, deems necessary and advisable to provide for the health, maintenance, support in their accustomed manner of living and education of Wife and/or Decedent's issue, or any of them.

Part I, Article Second(c) provides that at any time and from time to time during her lifetime, Wife is to have the exclusive power to appoint all or any part of the then remaining principal of the Family Fund, and the exclusive power to appoint all or any part of the income of Family Fund to or for the benefit of Decedent's issue, in such portions or amounts, and upon such estates, whether in trust or otherwise, as Wife is to designate pursuant to an instrument in writing, acknowledged in the same manner as is then required to record deeds of real estate in State and delivered to the trustee; and in

the event Wife is to appoint income, such appointment is to be for the life of the Family Fund or for such shorter period of time as Wife is to designate.

Part I, Article Second(d) provides that upon the death of Wife, the corpus is to pass “to such of [Decedent’s] issue, and in such portions or amounts, and upon such estate, whether in trust or otherwise, as [Wife] may appoint;” provided, that Wife is not deemed to have exercised the power of appointment unless she specifically refers the power in her will. If none of Decedent’s issue survive Decedent and Wife, the corpus is to pass to such person, persons, or beneficiaries (other than the estate of Wife, or the creditors of her estate) and in such portions or amounts, and upon such estates, whether in trust or otherwise, as Wife may appoint, provided that Wife is not deemed to have exercised the power of appointment unless she specifically refers to it in her will.

Part II, Article Thirteenth provides that except as provided in Article Seventeenth, Trust 1 may not be altered, amended, revoked or terminated in any respect whatsoever by anyone. In no event is any part of the principal of any trust created under the terms of Trust 1 to revert to Decedent, or be used in satisfaction of Decedent’s legal obligation to support any beneficiary of Decedent. In no event shall Decedent ever act as Trustee of Trust 1.

Part II, Article Fifteenth provides that unless terminated sooner under the provisions of Article Second of Part I, all trusts created under Trust 1 must terminate 21 years after the death of the last survivor of Decedent, Wife and Decedent’s issue living on the date of execution of Trust 1. The remaining principal and undistributed income is to be distributed to the beneficiary to whom the Trust income is then being applied.

Under Part II, Article Seventeenth, Decedent reserves the power to appoint trustees and to remove and replace trustees with corporate entities, or with individuals other than himself, and eliminate or change the order or succession of any successor trustees designated in the instrument. On Date 2 (before September 25, 1985), Decedent executed a document entitled “Amendment to [Trust]”. The document recites that Wife resigns as trustee effective on Date 3 (also before September 25, 1985) and that Individual 1 is appointed as successor trustee effective on Date 3. The document further recites that Article Seventeenth is deleted and a new Article substituted. Under the terms of new Article Seventeenth, if during the Decedent’s life, the trustee should die, resign, or become incapacitated, the Decedent is to name a new trustee who is not a related or subordinate party as defined in section 672 of the Internal Revenue Code. Further, the Decedent reserves the right to remove the trustee and name a new corporate banking institution to serve as trustee. Following Decedent’s death, Wife, Individual 1 and another individual (who subsequently predeceased Decedent) are to serve as co-trustees. If at any time following Decedent’s death, Wife is serving as sole trustee, Wife must designate a corporate banking institution to serve as co-trustee. Finally, except as provided in new Article Seventeenth, the Decedent released any

power to name a successor trustee, remove a trustee serving during Decedent's lifetime, or change the trustees serving after his death.

Since Decedent's death on Date 4, in accordance with new Article Seventeenth, Wife and Individual 1 have been serving as co-trustees of Trust 1.

Wife executed a will on Date 6. In Article V of Wife's will, Wife exercises the power of appointment that was granted to her by Decedent pursuant to Part I, Article Second(d) of Trust 1, by appointing the assets of Trust 1 to the trustees of Trust 2, a testamentary trust established under Article IV, Paragraph C of Wife's will.

Under the terms of Trust 2, if Son survives Wife, the trustees are to pay the income from Trust 2 in quarterly or more frequent installments to Son during his lifetime.

The trustees may, in their sole discretion, pay to Son and his issue, or for his or their benefit, or for the benefit of any one of them, such amounts of principal of Trust 2 as the trustees deem necessary or advisable, from time to time for the health, support, maintenance, and education of Son or his issue.

Upon the death of Son, or if Son fails to survive Wife, upon Wife's death, the trustees are to continue to hold Trust 2 in further trust and are to pay to Son's issue such sums from the income and principal of this portion of Trust 2 as the trustee deems advisable for the health, maintenance, support, and education of each individual, considering the income of each of them from all sources known to the trustees. The trustees shall not be required to equalize the distributions of principal among members of the group, nor shall the amount of any distribution be deducted from any beneficiary's share of the trust estate. Upon the earlier of (i) the expiration of 21 years from the date of Son's death; and (ii) the 90th anniversary of Wife's death, the trust is to terminate, and the trustees are to distribute all unpaid income and principal remaining in Trust 2 to the issue of Son, in equal shares, per stirpes.

Decedent died on Date 4. It is represented that Wife has not exercised the inter vivos power of appointment granted under Part I, Article Second(c) of Trust 1. In addition, the taxpayer represents that on Date 5 (after September 25, 1985) Wife transferred \$a to Trust 1. No other additions have been made to Trust 1.

You have requested the following rulings:

1. The testamentary exercise by Wife of the limited power of appointment, granted to her under Trust 1 in favor of Trust 2 will not cause the property held in Trust 1 to be included in Wife's gross estate.
2. The exercise by Wife of the testamentary limited power of appointment granted to her under Trust 1, in favor of Trust 2, will not constitute a constructive addition

to Trust 1 or Trust 2 and, accordingly, except for the Non-exempt portion, Trust 2 will be exempt from the GST tax under section 26.2601-1(b)(1)(v)(B) of the Generation-Skipping Transfer Tax Regulations.

LAW AND ANALYSIS

Ruling 1

Section 2033 provides that a decedent's gross estate shall include the value of all property to the extent of the decedent's interest at the time of death.

Section 2038(a)(1) provides that the value of the decedent's gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Section 2041(a)(2) provides for the inclusion in the gross estate of a decedent any property with respect to which the decedent possesses, at the time of his death, a general power of appointment created after October 21, 1942.

Section 2041(a)(3) provides for the inclusion in the gross estate of a decedent any property with respect to which the decedent by will exercises a power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

Section 2041(b)(1)(A) provides that the term "general power of appointment" means a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate, except that a power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is not deemed a general power of appointment. Section 20.2041-1(c)(2) of the Estate Tax Regulations provides that a power exercisable for the holder's "support," or "support in his accustomed manner of living" is limited by the requisite standard.

Section 20.2041-1(c)(1) of the Estate Tax Regulations provides that a power of appointment is not a general power of appointment if by its terms it is either (a) exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate, or (b) expressly not exercisable in favor of the decedent or his creditors, or the creditors of decedent's estate.

Section 20.2041-3(e)(1) provides that property subject to a power of appointment created after October 21, 1942, which is not a general power, is includible in the gross estate of the holder of the power under section 2041(a)(3) if the power is exercised, and if both of the following conditions are met:

(i) If the exercise is (a) by will, or (b) by a disposition which is of such nature that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's gross estate under sections 2035 through 2037, and

(ii) The power is exercised by creating another power of appointment which, under the terms of the instruments creating and exercising the first power and under applicable local law, can be validly exercised so as to (a) postpone the vesting of any estate or interest in the property for a period ascertainable without regard to the date of the creation of the first power, or (b) (if the applicable rule against perpetuities is stated in terms of suspension of ownership or of the power of alienation, rather than of vesting) suspend the absolute ownership or the power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

Finally, section 20.2041-1(b)(2) provides that the term "power of appointment" does not include powers reserved by the decedent to himself or herself within the concept of sections 2036 to 2038. No provision of section 2041 or the applicable regulations is to be construed as in any way limiting any other section of the Internal Revenue Code.

In the present case, Article Second(d) of Trust 1 grants Wife a testamentary power of appointment. Wife cannot exercise the power in favor of herself, her creditors, her estate, or the creditors of her estate. Therefore, her testamentary power is not a general power of appointment. Accordingly, based on the facts presented and the representations made, we conclude that the testamentary exercise by Wife of the limited power of appointment, granted to her under Article Second(d) of Trust 1 in favor of Trust 2 will not cause the property held in Trust 1 to be included in Wife's gross estate for federal estate tax purposes.

However, as noted above, Wife transferred \$a to Trust 1. Accordingly, in view of Wife's powers with respect to Trust 1 corpus, the portion of Trust 1 corpus, attributable to Wife's \$a transfer, will be includible in Wife's gross estate under section 2038(a)(1). See sections 20.2038-1(a) and 20.2041-1(b)(2).

Ruling 2

Section 2601 imposes a tax on every generation-skipping transfer.

Under section 1433(a) of the Tax Reform Act of 1986 (Act) and section 26.2601-1(a) of the Generation-Skipping Transfer (GST) Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i), the GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). However, this rule does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12. The transfer is made by the person holding the power at the time the exercise, release, or lapse of the power becomes effective, and is not considered a transfer under a trust that was irrevocable on September 25, 1985.

Under section 26.2601-1(b)(1)(iv)(A), if an addition is made after September 25, 1985, to an irrevocable trust that is excluded from chapter 13 under section 26.2601-1(b)(1), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to chapter 13 (the non-chapter 13 portion) and a portion subject to chapter 13 (the chapter 13 portion), each with a separate inclusion ratio (as defined in section 2642(a)). The non-chapter 13 portion represents the value of the assets of the trust as it existed on September 25, 1985. The applicable fraction (as defined in section 2642(a)(2)) for the non-chapter 13 portion is deemed to be 1 and the inclusion ratio is zero. The chapter 13 portion of the trust represents the value of all additions made to the trust after September 25, 1985. The inclusion ratio for the chapter 13 portion is determined under section 2642(a)(1). Section 26.2601-1(b)(1)(iv)(A) further provides that a constructive addition under section 26.2601-1(b)(1)(v) is treated as an addition. Section 26.2601-1(b)(1)(iv)(B) and (C) provides rules for determining the pro rata portion of a GST that is subject to GST tax where a post-September 25, 1985 addition is made to a trust that was irrevocable on or before September 25, 1985.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided under section 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the trust after the post September 25, 1985, release, exercise, or lapse of a power of appointment over that

portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12.

Section 26.2601-1(b)(1)(v)(B) provides a special rule for certain powers of appointment. Under this section, the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in section 2041(b)) will not be treated as an addition to a trust if: (1) such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under section 26.2601-1(b)(1); and (2) in the case of an exercise, the power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of section 26.2601-1(b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. This section also provides that if a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

Section 26.2601-1(b)(1)(v)(D), Example 6, describes a situation where prior to the effective date of chapter 13, GP established an irrevocable trust under which the trust income was to be paid to GP's child, C, for life. C was given a testamentary power to appoint the remainder in further trust for the benefit of C's issue. In default of C's exercise of the power, the remainder was to pass to charity. C died on February 3, 1995, survived by a child who was alive when GP established the trust. C exercised the power in a manner that validly extends the trust in favor of C's issue until the later of May 15, 2064 (80 years from the date the trust was created), or the death of C's child plus 21 years. C's exercise of the power is a constructive addition to the trust because the exercise may extend the trust for a period longer than the permissible periods of either the life of C's child (a life in being at the creation of the trust) plus 21 years or a term not more than 90 years measured from the creation of the trust. On the other hand, if C's exercise of the power could extend the trust based only on the life of C's child plus 21 years or only for a term of 80 years from the creation of the trust (but not the later of the two periods) then the exercise of the power would not have been a constructive addition to the trust.

In Example 7 of section 26.2601-1(b)(1)(v)(D), the facts are the same as in Example 6, except that local law provides that the effect of C's exercise is to extend the term of the trust until May 15, 2064, whether or not C's child predeceases that date by more than 21 years. C's exercise is not a constructive addition to the trust because C exercised the power in a manner that cannot postpone or suspend vesting, absolute ownership, or power of alienation for a term of years that will exceed 90 years. The result would be the same if the effect of C's exercise is either to extend the term of the trust until 21 years after the death of C's child or to extend the term of the trust until the first to occur of May 15, 2064 or 21 years after the death of C's child.

In this case, Trust 1 became irrevocable, at the latest, on Date 2, which is before September 25, 1985. It is represented that Wife made an \$a addition to Trust 1 after September 25, 1985. In accordance with section 26.2601-1(b)(1)(iv)(A), for GST tax purposes, Trust 1 is treated as consisting of two portions, an Exempt portion that is not subject to chapter 13 and a Non-exempt portion that is subject to chapter 13.

As discussed above, the testamentary power granted to Wife under Part I, Article Second(d) of Trust 1 is a limited power of appointment that cannot be exercised in favor of herself, her creditors, her estate, or the creditors of her estate. Under Wife's will, this power of appointment will be exercised in favor of Trust 2, which must terminate no later than 21 years after Son's death, who was living when Trust 1 was executed. Accordingly, based on the facts submitted and representations made, we conclude that the testamentary exercise by Wife of the limited power of appointment, granted to her under Part 1, Article Second(d) of Trust 1 in favor of Trust 2 will not constitute a constructive addition to Trust 1 or Trust 2. In addition, Wife's power as trustee under Article Second(b), to appoint trust income and corpus to herself is limited by an ascertainable standard relating to her health, maintenance, support and education. See section 20.2041-1(c)(2). Further, Wife's power under Article Second(c) can not be exercised in favor of herself, her estate, her creditors or the creditors of her estate. Accordingly neither of these powers are general powers of appointment. Therefore, except for the Non-exempt portion, Trust 2 will be exempt from the GST tax under the authority of sections 26.2601-1(b)(1)(i) and 26.2601-1(b)(1)(v)(B). In this regard, we note that Wife is considered the transferor of the Non-exempt portion of Trust 1 for GST tax purposes and that the Non-exempt portion is subject to an estate tax inclusion period described in section 2642(f)(1).

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

George L. Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

Copy for section 6110 purposes
Copy of this letter